

COMPANY NOTE

Estimate Change

China | Industrials | Basic Materials

31 July 2017

Jefferies

Xinyi Glass (868 HK) In-line Interim Results; Aggressive Capacity Expansion Plan; Reiterate Buy

Key Takeaway

Interim results were in-line with expectation. Management is optimistic with float glass' outlook and plans to increase capacity by 50% by 2020. We estimate that it will cost around HK\$4bn. It is still early to worry about domestic glass demand given the lag time between glass demand and construction new starts (see note), in our view. Shares of XYG are now trading at 8x forward PE and 6% div yield, attractively valued.

Roadmap to a global player. Management is optimistic with the outlook of float glass, anticipating huge demand from ASEAN, Europe and the US. XYG is planning to expand float glass capacity by 50% by YE2020 (vs. 5.3mt in YE2017). We estimate that the capex required to be ~Rmb4bn, and should be well covered by its strong cash flow. As float glass new capacity is no longer permitted in China, we believe XYG has been actively looking for overseas expansion opportunities, including sites in US and Euro. However, no official plan has been announced yet.

Sales impacted by weaker RMB. Sales increased by 14% YoY, driven by the higher volume and ASP of float glass. However, sales of auto and architectural glass declined by 6% and 3%, respectively, mainly impacted by RMB depreciation and spinoff of Xinyi HK (Xinyi HK sales of HK\$23m in 1H17).

Margin expansion driven by float glass. Gross margin expanded by 170bps, driven by 8ppts margin expansion of float glass. However, margin squeezed slightly for auto and architectural, attributable to higher production cost. According to our estimation, raw material cost (soda ash + natural gas) of float glass has increased by 14% YoY during the period, while ASP of float glass increased by 24%, more than offsetting increased costs.

Healthy balance sheet. Net gearing rose to 42% from 37% at YE2016, mainly driven by increase in bill receivables of HK\$500m (licensed by PRC banks with maturities less than 6 months). Net gearing pretty much unchanged if we include the bills receivable into cash.

Stable dividend payout. Interim dividend of HK\$0.20/shr (vs. HK\$0.17/shr in 2016) with payout ratio maintained at around 48%, in-line with the past. We expect FY17 dividend of HK\$0.45/shr (implying 0.25/shr in the second half), equivalent to around 6% div yield.

Valuation/Risks

Maintain Buy with PT of HK\$9.3 based on SOTP, valuing its glass business (float/auto/construction glass) at 10x 2018E earnings and Xinyi Solar at current mkt price. Our PT implies 9x 2018E P/E and 2.1x 2018E P/B, in-line with the historical avg. Risks: Prices, demand, curr.

HKD	Prev.	2016A	Prev.	2017E	Prev.	2018E	Prev.	2019E
Rev. (MM)	--	12,848.0	14,405.0	14,198.0	14,877.0	14,746.0	15,282.0	15,150.0
Operating Profit (MM)	--	2,837.0	3,313.0	3,287.0	3,631.0	3,621.0	3,723.0	3,714.0
Net Profit	--	3,213.0	3,672.0	3,681.0	4,011.0	4,073.0	4,129.0	4,186.0
ROE	--	24.4%	--	24.0%	22.9%	23.1%	20.9%	21.1%
DPS	--	0.40	0.46	0.45	--	0.50	--	0.51
Cons. EPS	--	--	0.93	0.95	1.01	1.04	1.03	1.04
EPS								
FY Dec	--	0.83	0.95	0.94	1.03	1.04	1.06	1.07
FY P/E		9.7x		8.6x		7.8x		7.6x

BUY

Price target HK\$9.30
Price HK\$8.08^

Bloomberg: 868 HK
Reuters: 868.HK

Financial Summary

Net Debt (MM): HK\$4,911.0

Market Data

52 Week Range: HK\$8.42 - HK\$5.45

Total Entprs. Value (MM): HK\$36,599.1

Market Cap. (MM): HK\$31,688.1

Shares Out. (MM): 3,921.8

Float (MM): 1,851.6

Avg. Daily Vol.: 9,104,609

Howard Lau, CFA *

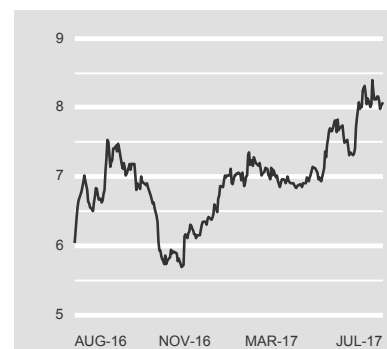
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Price Performance



^Prior trading day's closing price unless otherwise noted.

1H17 Earnings Review

- Sales increased by 14% YoY, driven by the higher volume and ASP of float glass. However, sales of auto and architectural glass both declined by 6% and 3%, respectively. The decline of auto glass was driven by RMB depreciation, sales dropped in South America as well as spin-off of Xinyi HK (8328 HK, NC), and the decline of architectural glass sale is because of RMB depreciation.
- Gross margin expanded by 170bps, driven by 8ppts expansion of float glass. However, margin was compressed for both auto and architectural glass, which was mainly due to increase of float glass production cost. According to our estimation, raw material cost (soda ash + natural gas) of float glass has increased by 14% YoY during the period, while ASP of float glass increased by 24%.
- Net gearing rises to 42% from 37% at YE16 driven by increase in bill receivables of HK\$500m (licensed by banks with maturities less than 6 months). Net gearing is unchanged if we include bills receivable as cash.
- Capital expenditure incurred in 1H17 was HK\$2.5bn, planned capex for the full year of HK\$3.0bn and shall be well covered by the strong operating cash flow.
- Planned capital expenditure for FY17 has increased from HK\$2.5bn to HK\$3.0bn, including HK\$1.8bn for the acquisition cost of Qianhai Land. The rest of the capex is mainly related to the capex for Malaysia capacity phase 2.
- Payout ratio was stable at around 48% with interim DPS of HK\$0.2/shr vs. HK\$0.17/shr in 1H16.
- Management expects annualized float glass capacity to increase by 7.1% YoY in 2017, mainly driven by the new capacity built in Malacca, Malaysia. The second phase of the Malaysia project is to commence operation in 2H18.
- The single digit percentage growth in auto glass capacity was purely driven by increase in efficiency.

PT of HK\$9.3

We value Xinyi Glass based on SOTP valuation methodology, valuing its glass business (float/auto/construction glass) at 10x 2018E earnings and Xinyi Solar at the current market price. Our PT of HK\$9.3 implies 9x 2018E P/E and 2.1x 2018E P/B, in-line with the historical average.

Chart 11: Xinyi Glass Valuation

Xinyi Glass	
Float/Auto/Construction Glass Business	
NPAT (2018E)	3,343
x Target multiple	10
Market Value (HK\$ m)	33,427
÷ Shares outstanding (m)	3,882
Share price (HK\$/share)	8.61
Xinyi Solar (968 HK)	
Current Share Price (HK\$)	2.46
XYG's shareholdings	30%
Market value of Xinyi Solar's holdings	0.73
Target Price	9.34
Rounded to HK\$0.10/share	9.30
Latest price	8.08
Upside	15%

Source: Jefferies estimates

Risks

Key risks to our estimates and PT: Liquidity tightening policy, which could negatively impact new floor spaces started and construction demand; collapse in float glass prices due to more than expected new capacity in operation and slowdown in demand growth; intensifying competition of high quality float glass product; additional expenses due to overseas capacity expansion; trade disputes and currency fluctuations.

Table 2: Valuation comparison

Company	Ticker	Mkt cap (US\$ bn)	Price (local)	Target (local)	Rec.	Upside to target	P/E (x)		P/B (x)		EV*/EBITDA (x)		ROE (%)		Div Yield (%)	
							2017E	2018E	2017E	2018E	2017E	2018E	2017E	2018E	2017E	2018E
Glass - H																
Fuyao Glass	3606 HK	8.7	26.70	24.00	Buy	-10%	18.6	16.7	3.1	2.9	9.8	8.8	16.8	17.5	3.8	4.2
Consensus							16.4	14.6	2.9	2.7	10.3	9.0	18.3	18.7	3.7	4.0
Xinyi Glass	868 HK	4.1	8.10	9.30	Buy	15%	8.6	7.8	2.1	1.8	7.9	7.1	24.0	23.1	5.6	6.2
Consensus							8.6	7.9	2.0	1.8	8.3	7.6	25.0	23.7	5.6	6.2
Flat Glass	6865 HK	0.3	1.51		NC		4.2	3.5	nmf	nmf	2.2	1.8	18.7	23.2	5.9	7.3
Average							10.5	9.3	2.6	2.4	6.7	5.9	19.8	21.3	5.1	5.9
Glass - A																
Fuyao Glass - A	600660 CH	8.7	23.45		NC		16.8	15.0	3.0	2.7	10.4	9.1	18.3	18.7	3.5	3.8
CSG Holdings	000012 CH	2.5	8.52		NC		22.7	19.4	nmf	nmf	nmf	nmf	nmf	nmf	nmf	nmf
Zhuzhou Kibing Group	601636 CH	2.1	5.17		NC		12.9	11.1	1.9	1.7	8.2	7.3	15.6	15.8	3.7	4.3
Jinjing Group	600586 CH	1.2	5.32		NC		10.9	nmf	nmf	nmf	nmf	nmf	nmf	nmf	nmf	nmf
Average							15.8	15.1	2.4	2.2	9.3	8.2	16.9	17.3	3.6	4.0

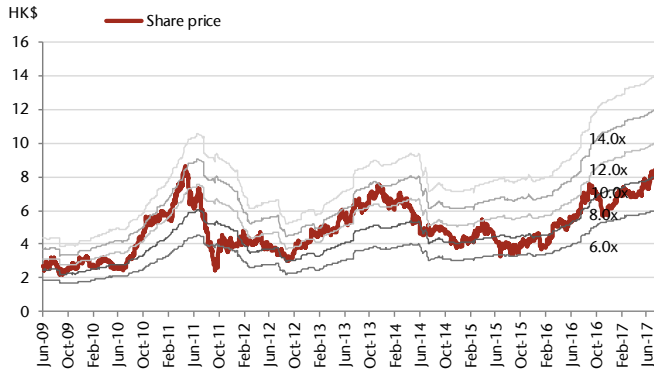
Source: Company data, Jefferies estimates, NC data from Bloomberg,

Table 8: Xinyi Glass Financials Summary

Income statement					Cash flow				
HK\$ m	2016	2017E	2018E	2019E	HK\$ m	2016	2017E	2018E	2019E
Revenue	12,848	14,198	14,746	15,150	Profit before tax	3,823	4,326	4,796	4,921
COGS	-8,189	-8,976	-9,115	-9,372	D&A	824	816	967	1,004
Gross profit	4,659	5,221	5,630	5,779	Change in working cap.	46	-156	-85	-44
Operating expenses	-1,822	-1,935	-2,009	-2,064	Other	-1,542	-649	-719	-738
Operating profit	2,837	3,287	3,621	3,714	CF from operations	3,151	4,338	4,959	5,142
Other gains - net	552	515	595	638	Capex	-1,853	-3,000	-1,500	-1,500
Share of results of assoc. & JCE's	563	664	730	730	Acquisitions and others	0	0	0	0
Finance costs	-128	-139	-150	-162	CF from investing	-1,853	-3,000	-1,500	-1,500
Pre-tax profit	3,823	4,326	4,796	4,921	Equity raised/ (repaid)	-1,467	0	0	0
Tax	-607	-649	-719	-738	Debt raised/ (repaid)	1,646	681	681	681
Profit	3,216	3,677	4,076	4,183	Dividends, interest and others	-981	-1,553	-1,779	-1,972
Minority interest	-3	3	-3	4	CF from financing	-802	-871	-1,097	-1,290
Net profit	3,213	3,681	4,073	4,186	Net cash flow	496	467	2,361	2,352
Basic EPS (Rmb)	0.83	0.94	1.04	1.07	Exchange gain	0	0	0	0
Diluted EPS (Rmb)	0.81	0.94	1.04	1.07	Cash at end of year	2,763	3,230	5,591	7,943
Balance sheet					Ratio & financial metrics analysis				
HK\$ m	2016	2017E	2018E	2019E		2016	2017E	2018E	2019E
Cash	2,763	3,230	5,591	7,943	Revenue Growth	12.1%	10.5%	3.9%	2.7%
Inventories	1,321	1,447	1,470	1,511	EBIT Growth	86.9%	15.9%	10.2%	2.6%
Receivables	2,377	2,627	2,728	2,803	EPS Growth	53.6%	13.2%	10.7%	2.8%
Other current assets	76	76	76	76	EBIT Margin	22.1%	23.2%	24.6%	24.5%
Fix assets	11,831	14,014	14,547	15,044	Net Profit Margin	25.0%	25.9%	27.6%	27.6%
Others assets	5,655	5,655	5,655	5,655	Payout Ratio	48.3%	48.3%	48.3%	48.3%
Total assets	24,022	27,049	30,067	33,032	Valuation metrics				
ST debt	3,165	3,817	4,468	5,119	PER (x)	9.8	8.6	7.8	7.6
Other current liabilities	2,835	3,056	3,095	3,167	EV/EBITDA (x)	10.0	9.0	7.7	7.1
LT debt	4,509	4,539	4,569	4,599	Price to Book (x)	2.4	2.1	1.8	1.6
Other LT liabilities	266	266	266	266	Balance Sheet Ratios				
Total liabilities	10,775	11,678	12,398	13,151	ROE	24.4%	24.0%	23.1%	21.1%
Shareholder's equity	13,181	15,309	17,603	19,821	ROCE	13.2%	13.7%	14.6%	14.6%
Minority interests	66	63	66	63	Net debt to Equity	37.1%	33.3%	19.5%	8.9%
Total liability & equity	24,022	27,049	30,067	33,035	Interest coverage (x)	28.7	29.5	30.5	29.2
					Book value per share	3.4	3.9	4.5	5.0

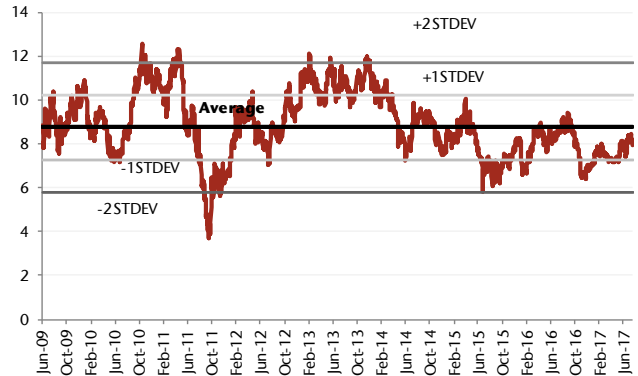
Source: Company data, Jefferies estimates

Chart 63: Xinyi Glass Historical PE Chart



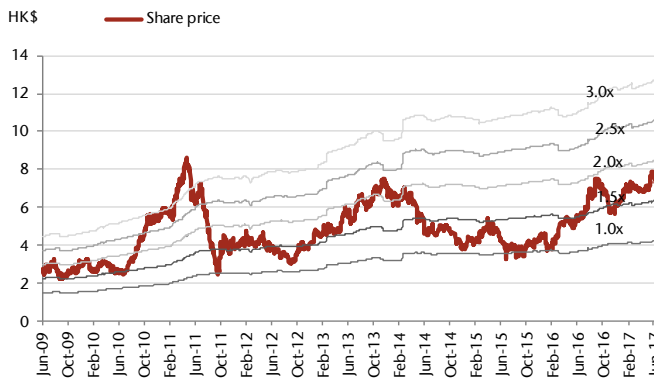
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Chart 7: Xinyi Glass Historical PE Chart



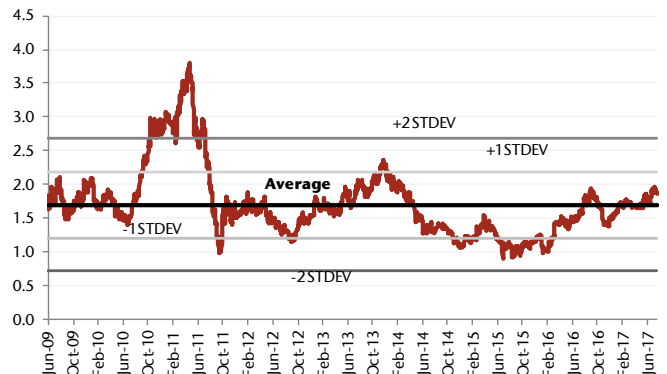
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Chart 8: Xinyi Glass Historical PB Chart



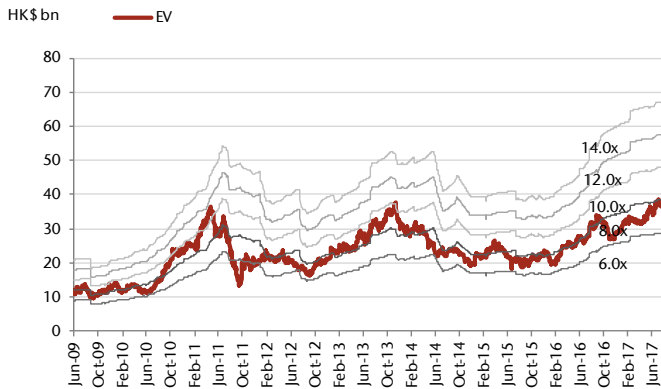
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Chart 9: Xinyi Glass Historical PB Chart



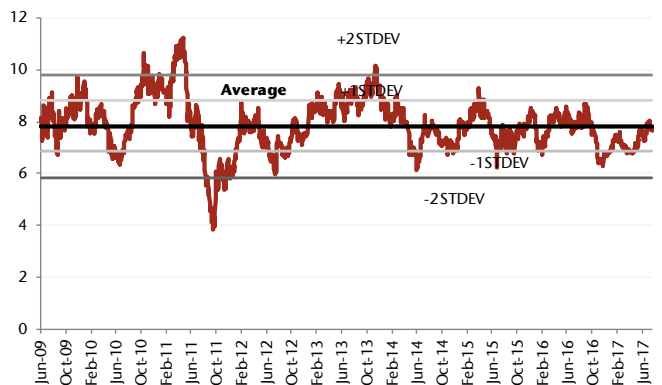
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Chart 10: Xinyi Glass Historical EV/EBITDA Chart



Source: Bloomberg, Jefferies

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PT of HK\$9.3

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Glass - H																
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Jinjing Group	600586 CH	1.2	5.32		NC		10.9	nmf	nmf	nmf	nmf	nmf	nmf	nmf	nmf	nmf
Average							15.8	15.1	2.4	2.2	9.3	8.2	16.9	17.3	3.6	4.0

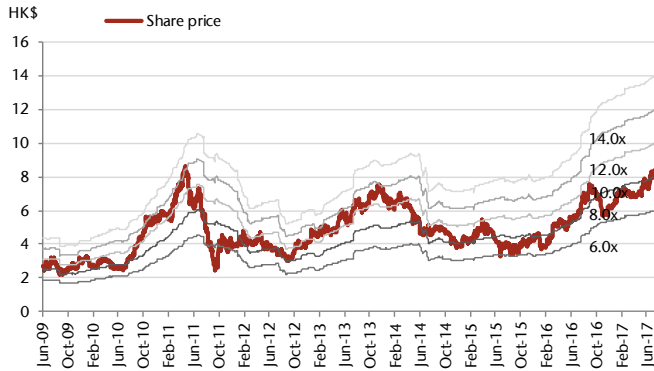
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Gross profit	4,659	5,221	5,630	5,779	Change in working cap.	46	-156	-85	-44
Operating expenses	-1,822	-1,935	-2,009	-2,064	Other	-1,542	-649	-719	-738
Operating profit	2,837	3,287	3,621	3,714	CF from operations	3,151	4,338	4,959	5,142
Other gains - net	552	515	595	638	Capex	-1,853	-3,000	-1,500	-1,500
Share of results of assoc. & JCE's	563	664	730	730	Acquisitions and others	0	0	0	0
Finance costs	-128	-139	-150	-162	CF from investing	-1,853	-3,000	-1,500	-1,500
Pre-tax profit	3,823	4,326	4,796	4,921	Equity raised/ (repaid)	-1,467	0	0	0
Tax	-607	-649	-719	-738	Debt raised/ (repaid)	1,646	681	681	681
Profit	3,216	3,677	4,076	4,183	Dividends, interest and others	-981	-1,553	-1,779	-1,972
Minority interest	-3	3	-3	4	CF from financing	-802	-871	-1,097	-1,290
Net profit	3,213	3,681	4,073	4,186	Net cash flow	496	467	2,361	2,352
Basic EPS (Rmb)	0.83	0.94	1.04	1.07	Exchange gain	0	0	0	0
Diluted EPS (Rmb)	0.81	0.94	1.04	1.07	Cash at end of year	2,763	3,230	5,591	7,943
Balance sheet					Ratio & financial metrics analysis				
HK\$ m	2016	2017E	2018E	2019E		2016	2017E	2018E	2019E
Cash	2,763	3,230	5,591	7,943	Revenue Growth	12.1%	10.5%	3.9%	2.7%
Inventories	1,321	1,447	1,470	1,511	EBIT Growth	86.9%	15.9%	10.2%	2.6%
Receivables	2,377	2,627	2,728	2,803	EPS Growth	53.6%	13.2%	10.7%	2.8%
Other current assets	76	76	76	76	EBIT Margin	22.1%	23.2%	24.6%	24.5%
Fix assets	11,831	14,014	14,547	15,044	Net Profit Margin	25.0%	25.9%	27.6%	27.6%
Others assets	5,655	5,655	5,655	5,655	Payout Ratio	48.3%	48.3%	48.3%	48.3%
Total assets	24,022	27,049	30,067	33,032	Valuation metrics				
ST debt	3,165	3,817	4,468	5,119	PER (x)	9.8	8.6	7.8	7.6
Other current liabilities	2,835	3,056	3,095	3,167	EV/EBITDA (x)	10.0	9.0	7.7	7.1
LT debt	4,509	4,539	4,569	4,599	Price to Book (x)	2.4	2.1	1.8	1.6
Other LT liabilities	266	266	266	266	Balance Sheet Ratios				
Total liabilities	10,775	11,678	12,398	13,151	ROE	24.4%	24.0%	23.1%	21.1%
Shareholder's equity	13,181	15,309	17,603	19,821	ROCE	13.2%	13.7%	14.6%	14.6%
Minority interests	66	63	66	63	Net debt to Equity	37.1%	33.3%	19.5%	8.9%
Total liability & equity	24,022	27,049	30,067	33,035	Interest coverage (x)	28.7	29.5	30.5	29.2
					Book value per share	3.4	3.9	4.5	5.0

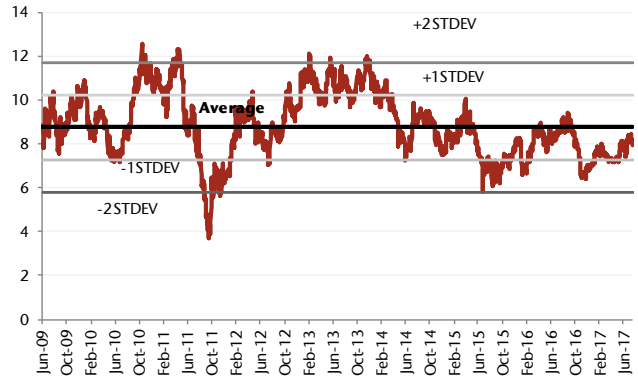
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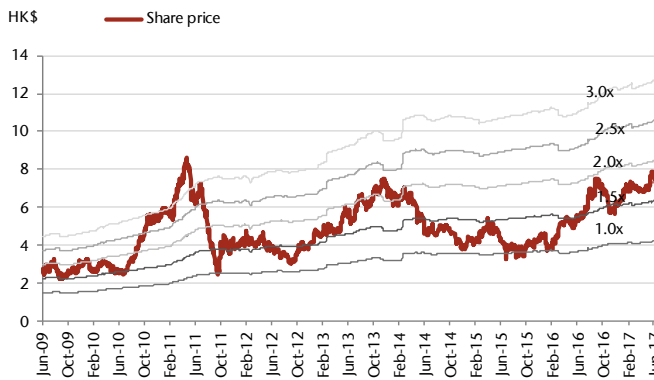
Source: Bloomberg, Jefferies

Chart 7: Xinyi Glass Historical PE Chart



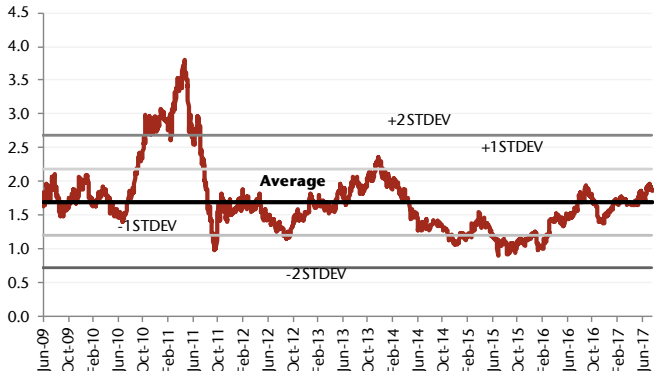
Source: Bloomberg, Jefferies

Chart 8: Xinyi Glass Historical PB Chart



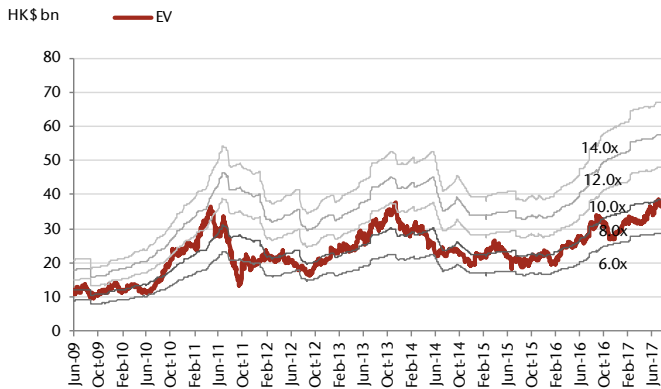
Source: Bloomberg, Jefferies

Chart 9: Xinyi Glass Historical PB Chart



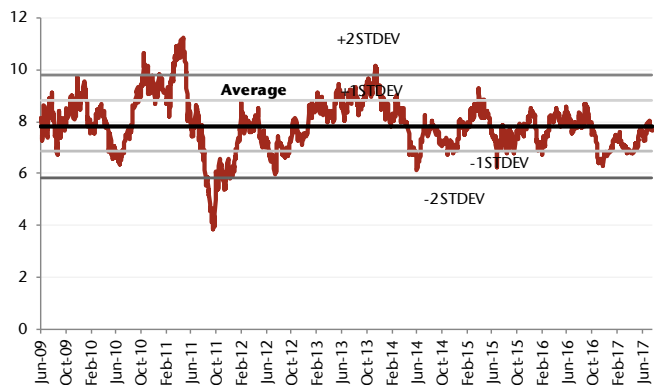
Source: Bloomberg, Jefferies

Chart 10: Xinyi Glass Historical EV/EBITDA Chart



Source: Bloomberg, Jefferies

Chart 64: Xinyi Glass Historical EV/EBITDA Chart



Source: Bloomberg, Jefferies

Company Description

Xinyi Glass is engaged in the production and sales of a wide range of glass products, including automobile glass, energy saving construction glass, high quality float glass and other glass products. Its customers include companies in the business of automobile glass manufacturing, wholesale and distribution, curtain wall engineering and installing, construction and furniture glass manufacturing, and float glass wholesale and distribution. As of YE15, the company has ~5mt of float glass capacity.

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(Article 3(1)e and Article 7 of MAR)

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Underperform - Describes securities that we expect to provide a total return (price appreciation plus yield) of minus 10% or less within a 12-month period.

The expected total return (price appreciation plus yield) for Buy rated securities with an average security price consistently below \$10 is 20% or more within a 12-month period as these companies are typically more volatile than the overall stock market. For Hold rated securities with an average security price consistently below \$10, the expected total return (price appreciation plus yield) is plus or minus 20% within a 12-month period. For Underperform rated securities with an average security price consistently below \$10, the expected total return (price appreciation plus yield) is minus 20% or less within a 12-month period.

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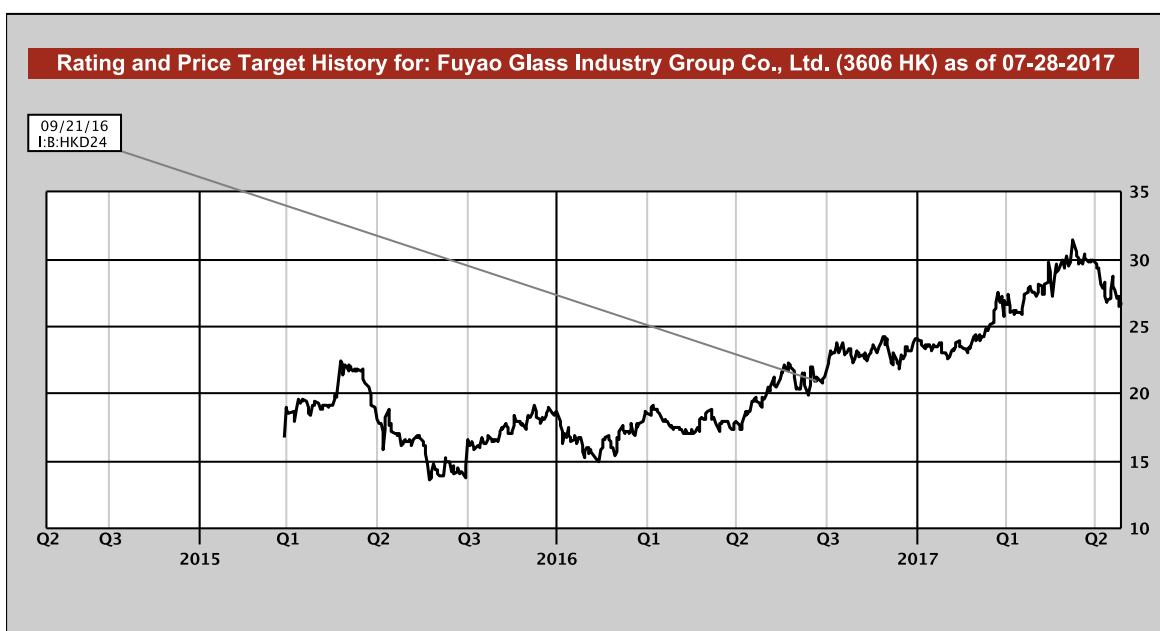
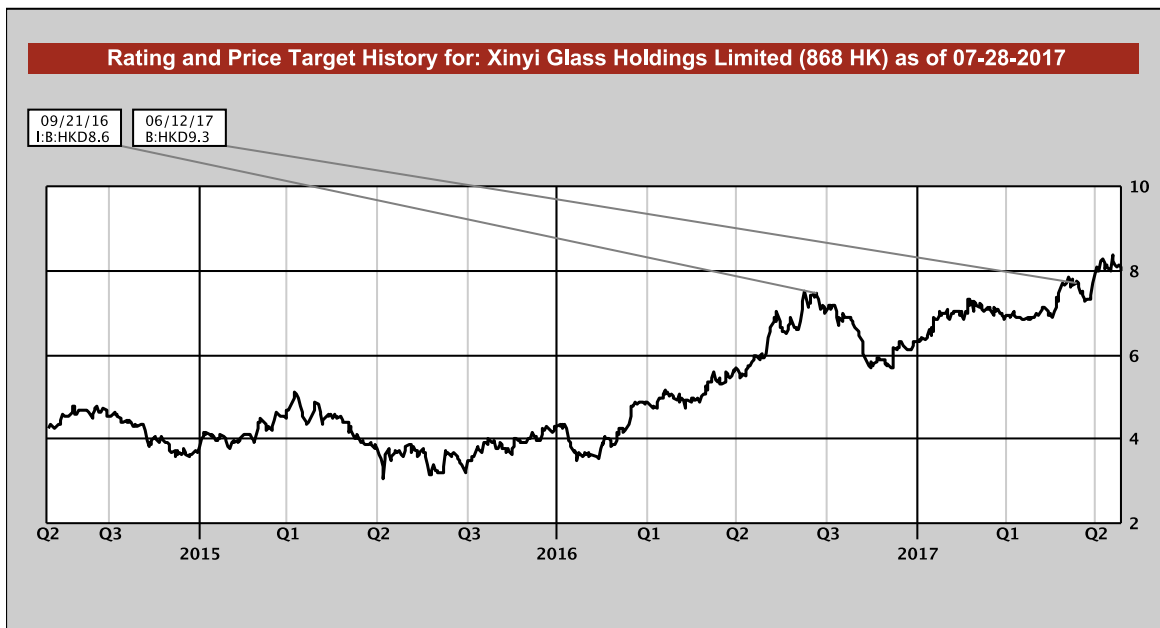
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Other Companies Mentioned in This Report

- Fuyao Glass Industry Group Co., Ltd. (3606 HK: HK\$26.65, BUY)



Notes: Each box in the Rating and Price Target History chart above represents actions over the past three years in which an analyst initiated on a company, made a change to a rating or price target of a company or discontinued coverage of a company.

Legend:

I: Initiating Coverage

868 HK

Estimate Change

31 July 2017

D: Dropped Coverage

B: Buy

H: Hold

UP: Underperform

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Rating	Count	Percent	IB Serv./Past 12 Mos.	
			Count	Percent
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